Research Proposal

Ph.D. in Management Studies

A Study of Effectiveness of Risk Management and Governance of Mutual Funds in India

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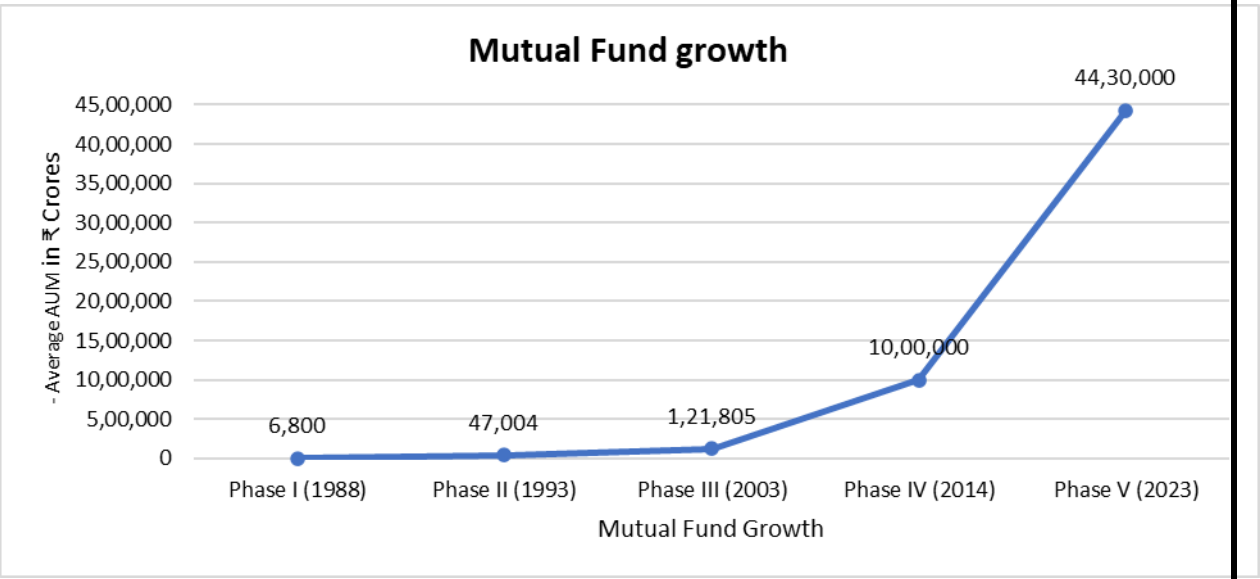
A Study of Effectiveness of Risk Management and Governance of Mutual Funds in India

Introduction and Research Background

Mutual funds have a vital role to play in nurturing inclusivity and financial growth by pooling small and big savings from myriad investor groups into sizeable investments to propel economic growth of any economy and to achieve attractive returns. The funds thus pooled are utilized within financial markets, while considering the diverse appetite for preferences and risk-returns In India, the mutual fund industry has seen a rapid growth right from the time of the market liberalization in 1993. Prior to 1991, the mutual fund industry was dominated by UTI, and subsidiaries of public sector banks and insurance companies. Entry of private fund managers both from India and abroad, saw the beginning of a new era, where major growth in terms of assets that were managed by the fund industry.

The mutual fund industry has witnessed an exponential growth as evident through the growth in terms of size of Average Assets Under Management (AAUM). From ₹ 6,700 crores of Assets Under Management (AUM) in 1988 to ₹47,004 crores in 1992, the AAUM was about ₹97,028, at the turn of the century in December 1999.



(*Association of Mutual Funds in India*, n.d.)

By the end of July 2023, the AAUM has swollen 44 crore times. The AAUM as of July 2023 is a whopping ₹44 trillion ***(Association of Mutual Funds in India, n.d.)***. From the traditional dominance of the banking industry to the non-banking sector, which also includes the asset management sector, the

mutual fund sector in India is evolving as a highly competitive section within the financial sector. When compared to March 2023 data, banks reported a gain in deposits of 6.2%, while mutual fund Assets Under Management (AUM) growth was greater at 12.6% during the quarter ended June 2023 **(*Banks Face Stiff Competition from Mutual Funds in Mobilising Capital | Business News - The Indian Express*, July 17, 2023)**.

For the quarter that ended in June 2023, bank deposits increased by Rs 11.16 lakh crore to Rs 191.6 lakh crore. Of this, time deposits (fixed deposits) increased by 5.3% to Rs 167.11 lakh crore. This is despite the elimination of Rs 2,000 notes and the need to pay taxes on loan funds. In response to the Reserve Bank of India's increase in the Repo rate, banks also increased interest rates on deposits, increasing returns to depositors. For deposits with a 15-month term, private banks provide 7% to 7.10 percent Mutual fund AUM, however, increased by Rs 4.97 lakh crore to Rs 44,39 lakh crore in the June quarter. Growth fund AUM increased by 14.9% to Rs 17.43 lakh crore, while assets of income funds increased by 14%, or Rs 1.65 lakh crore ***(Banks Face Stiff Competition from Mutual Funds in Mobilising Capital | Business News - The Indian Express, July 17, 2023).***

Retail participation in the mutual funds industry has also been increasing at a rapid pace. The younger generation of employees had higher disposable income, as the opportunities were less to spend during the Covid pandemic. The work-from-home options provided an opportunity to invest funds, which were hitherto, mostly consumed. This is evident from the following report "Of the net resources mobilised by mutual funds of `2.5 lakh crore during 2021-22, systematic investment plan (SIP) contributions witnessed a healthy growth - an indication of rising retail participation and financialisation of household savings. Equity-oriented schemes witnessed net mobilisation of `1,54,094 crore in 2021-22 as against net redemption of `39,327 crore in the previous year. Assets under management (AUM) of equity-oriented mutual funds increased by 37.2 per cent to `13.7 lakh crore at end-March 2022 from `10 lakh crore at end-March 2021' **(*RBI Annual Report, 2021-22*, n.d.).**

Further, " Average monthly contributions to mutual funds through systematic investment plan (SIP) increased to `12,998 crore in 2022-23 from `10,381 crore in the previous financial year" ***(Banks Face Stiff Competition from Mutual Funds in Mobilising Capital | Business News - The Indian Express, n.d.)***. The total number of accounts (or folios as per mutual fund parlance) as on July 31, 2023 stood at 15.14 crore (151.4 million), while the number of folios under Equity, Hybrid and Solution Oriented Schemes, wherein the maximum investment is from retail segment stood at about 12.08 crore (120.8 million) ***(Association of Mutual Funds in India, n.d.).***

From the foregoing one can see the rapid growth in the mutual funds sector in recent years. While banks have got a global risk management programme, standardised by the Bank for International Settlements (BIS), the risk management programme for mutual funds is largely managed by the regulator in each jurisdiction.

SEBI regulations for mutual funds provide a regulatory framework for mutual fund organisations in India. Regulations and guidelines are periodically updated and issued for regulating the market and SEBI has been undertaking essential initiatives to ensure a mutual fund market that is free from fraud for investors and organizations,

It is interesting to note that any advertisement campaigning for a mutual fund ends with 'mutual fund investments are subject to market risk. With the unabated growth of mutual fund AAUM and number of folios, SEBI has the difficult task of nudging the mutual fund industry to manage investors' wealth carefully against all types of risks not just the market risk. The phrase 'market risk' in itself is all encompassing, and responsibility of mutual fund organisations is that such risk do not diminish the value of investors' wealth and their confidence in the mutual fund industry itself. In the last three decades, after UNIT 64 and some assured return schemes in the early 1990s, there have been no mutual fund defaults. Having said that the mutual fund industry did face liquidity crisis post Lehman Brothers incident and also in some liquidity glitches in debt funds in the last 8 years. This research intends to investigate the adequacy of regulations (consider saying the risk management framework prescribed by the regulator and risk management practices followed by mutual fund industry) in enhancing risk management and governance of mutual funds in India.

Need for Research

The need for enterprise risk management and governance has been gaining traction world over. This is at the back of innumerable scandals, frauds and errors, resulting in significant losses to the investor. Mutual funds represent the investments and retirals of individual investors and that needs to be carefully protected. The fiduciary responsibility of the funds needs no explanation. Unless Mutual Funds are carefully managed, the economy will lose the benefit of mutual funds' strength in countering the volatility brought in by FPI investments in the country on the one hand and sustaining investor confidence and to provide alternative investment opportunities (against savings in banks) to investors on the other.

In order to ensure that mutual funds render, at all times, high standards of service, exercise due diligence, ensure proper care in their operations and to protect the interests of investors, SEBI vide Circular No. MFD/CIR/15/19133/2002, dated September 30, 2002 prescribed certain systems, procedures and practices that must be followed by all mutual funds with regard to risk management in various areas like fund management, operations, customer service, marketing and distribution, disaster recovery and business contingency, etc. Since the date of issuance of the aforesaid circular, there have been significant developments in the mutual fund industry and in the financial markets as a whole, including in the area of product innovation, investment in newer asset classes, distribution landscape, technological evolution, investor penetration and awareness, increase in risk elements, etc.

With the overall objective of management of key risks involved in mutual fund operation, the revised Risk Management Framework (RMF) issued by SEBI in September, 2021, shall provide a set of principles or standards, which inter alia comprise the policies, procedures, risk management functions and roles & responsibilities of the management, the Board of AMC and the Board of Trustees **(*SEBI | Risk Management Framework (RMF) for Mutual Funds - September 27, 2021*, 2021).**

Implementing Enterprise Risk Management framework in an organisation is a complex exercise. It is fraught with lots of challenges. There are many misconceptions about ERM that limit organizations' abilities to implement ERM. Fraser and Simkins, opine that much progress has not been made in overcoming these issues and continues to remain ***(Fraser & Simkins, 2016).*** Through this study, we will try to understand the challenges in implementing any ERM framework, especially the SEBI RMF, September 2021.

SEBI (Mutual Funds) Regulations 1996 prescribe the duties and obligations of asset management companies (AMCs) and trustees. The code of conduct prescribed under the Regulations requires that mutual funds should always render high standards of service and exercise due diligence and ensure proper care in their operations ***(SEBI Circular - Risk Management System - September, 2002 and several ciruclars issued thereafter).*** The obligation has been cast on the Board of Directors and Trustees to be diligent and perform their fiduciary duties with adequate care with a focus on protecting investors' interest. There is a need to understand if the Boards are able to play their expected roles with diligence.

Ahmed Barakat and Khaled Hussainey, opine that banks having a higher proportion of outside board directors, lower executive ownership, concentrated outside non-governmental ownership, and more active audit committee, and operating under regulations promoting bank competition (i.e., less stringent entry to banking requirements) provide Operational Risk Disclosure of higher quality ***(Barakat & Hussainey, 2013)***.

Rationale for the Study

This doctoral research study aims to explore the adequacy of regulations in enhancing risk management and governance in mutual funds in India. The mutual fund industry plays a crucial role in the country's financial ecosystem, intermediate between individual investors and capital markets. However, these funds carry inherent risks, making robust risk management and governance practices essential for safeguarding investor interests and overall financial stability.

SEBI has issued a regulatory management framework for mutual funds in India, in September 2021, over 2 decades after the earlier risk management guidelines issued in 2002. Through this study, we will examine to what extent this framework has benefitted the industry and the individual investors.

Effective risk management and governance practices can protect investors' capital and foster trust in the financial system. A well-regulated mutual fund industry with transparent risk management and governance mechanisms enhances market confidence, fund performance through better risk strategies, enhanced employee morale and good reputation.

The research outcomes can provide evidence-based insights to regulatory authorities for refining existing regulations and designing future policy measures that better align with industry needs and investor protection. By identifying the best practices emerging from regulatory changes and challenges in implementing the framework, the study can contribute to disseminating knowledge on effective risk management and governance approaches among industry participants.

The findings have the potential to inform both industry practices and regulatory decisions, benefiting not only the mutual fund sector but also the broader financial ecosystem and its stakeholders.

Scope of the Study

The scope of the study will cover the risk management framework prescribed by the regulator SEBI and various circulars issued from time to time. The study will be covering the mutual funds registered with SEBI and may be based out of India. This study is restricted to the mutual fund offerings of the asset management company. It will not cover portfolio management schemes, or any other products offered. Further, the focus will be more towards non-financial risks and limited to the investment risk per se.

Literature Review

The literature for the topic was searched through internet search engines, using the appropriate with the keywords of Enterprise Risk Management, Risk Management, Governance, Corporate Governance, Mutual Funds, Stewardship, Regulatory Framework, Asset Management and many other similar words, their combinations and search terms. The research scholar has held discussions with various stakeholders. Discussions with other senior professionals in the industry has helped frame the topic, issues, challenges, methodologies etc.

Based on the review of these summaries, abstracts, regulations and reading of the various items, relevant information was assimilated for focused reading and presentation. During the actual research, it is planned to use more sophisticated tools to gather information, filter the needed and review the same.

Concept of Enterprise Risk Management

Enterprise Risk Management (ERM) has become very critical for governance of enterprises due to rising uncertainties and failure of traditional risk management in recognizing interactions among risks. But ERM implementation across the globe remains immature, more so in India ***(Ghosh, 2013).*** Financial services sector like Banks were focusing more on credit and market risk, which is their main risk profile and mutual funds were focusing on liquidity risk, investment risk and counterparty risk.

It has become very critical for the governance of enterprises due to rising uncertainties and failure of traditional risk management in recognizing interactions among risks. But ERM implementation across the globe remains immature, more so in India. It further explores whether ERM adoption leads to increase in firm value. The findings suggest that firm size, leverage, profitability, and firm complexity

influence the likelihood of ERM adoption. The results further reflect that firms which embrace ERM experience a positive effect on their firm value ***(Ghosh, 2013).***

Different Risk Types in Mutual Funds

Risk is a vague concept for most investors. Most conservative investors see only risk everywhere, while aggressive investors focus solely on returns since they believe they can face any kind of risk. However, risk is not such a vague or simple concept. There are various risks associated with investments that investors often overlook for reasons known or unknown to them ***("Do You Really Understand Various Risks Associated with Your Investment Life?," 2019*)**. Investors and even mutual funds, and regulators were focusing more on investment risks and returns, fund performance and transparency.

Non-financial risks, such as operational, reputational and strategic risks, are becoming increasingly important in the banks' risk map compared to more established financial risks. On the one hand, this is due to sometimes spectacular losses. On the other hand, this is because supervisory authorities and standard setters are increasingly focusing on these risks in the assessment of risk-bearing capacity as well as in individual special audits ***(Non-Financial Risks - KPMG Germany, 2023)*.** This research will go over some of these risks in detail in the following section, as applicable to the mutual funds industry.

While on the one hand, we see exponential growth in Average Assets Under Management (AAUM), the operational risk events are rising. While we do not have industry specific data relating to India, some of the global trends provide an idea of some of the risk challenges that financial services industry faces. Data from ORX, the world's largest operational risk association, found that more sophisticated technology and low-risk fraud had led to a reported loss number of 76,620 events in 2022, a 26.4% rise of 16,020 from the previous year. The 76,000-plus operational risk loss events totaled €17.8bn in gross loss. This represents an average decrease of €1.6bn per year, and a drop of €8.2bn total gross loss between 2017 and 2022, ORX found **(Banks Report Lowest Financial Losses in 2022 – ORX, n.d.).** The Annual Banking Loss Report also found:

- Eight out of 10 (80%) loss incidents happened in banks' retail and commercial businesses.
- Around one in 20 (6%) were in trading and investment.
- Around one in 10 (10%) happened in banks' corporate business.

While the above statistics relate to a global survey, this research will aim to get more details relating to the Indian environment. SEBI has been issuing its industry wide observations arising out of its annual inspections, which is in in public domain -SEBI website and annual reports. These shall be studies operational risk aspects shall be listed. While no numbers can be attributed to that, it will give a view on the operational risk elements.

As mentioned earlier, the concept of ERM has not been practiced holistically and in a structured manner. It took many risk events, regulatory interventions to boost this. Risk was managed through the broader regulations and corporate accounting requirements. Infact, the first circular in operational risk was issued by Reserve Bank of India in 1999 ***(RBI - Risk Management in Banks, 1999)*** and Securities & Exchange Board of India in 2002 ***(SEBI Circular - Risk Management System -, 2002)***.

SEBI's 2023 RMF circular outlines a few risk types that are attributed to the scheme and to the AMC that manages the mutual fund schemes. SEBI (Mutual Funds) Regulations, 1996 vide various circulars has prescribed certain norms which would cover many aspects of risk management such as stress testing, internal credit risk assessment, cyber security and system audit, liquidity buffer, creation of segregated portfolio, investment restrictions, investment due diligence, etc. that are to be adhered to by the mutual funds.

There are comprehensive guidelines for the management of various key risks by the AMCs, elements of which may overlap with the above-mentioned norms and in such cases, the detailed norms specified in the relevant circular must be strictly followed.

These key risks may be divided into two broad categories.

i. **Scheme specific risks -** The scheme specific risks are the risks majorly associated with the core activities of investment and portfolio management.
ii. **AMC specific risks -** The AMC specific risks are the risks associated with the functioning of the mutual fund business by the AMC.

The scheme specific risks may be divided in to the following categories - Investment risk, Credit risk, Liquidity risk and Governance risk

The AMC specific risks may be divided in to the various categories - Operational Risk, Technology, Information Security and Cyber Risk, Reputation and Conduct Risks, Outsourcing Risk, Sales and

Distribution Risk, Financial Reporting Risk, Legal & Tax Risks and Talent Risk. The compliance risk shall be applicable for both investment management activity (scheme specific risk) and business activity of AMC - AMC specific risk ***(SEBI | Risk Management Framework (RMF) for Mutual Funds, 2021).***

While the mutual funds usually refer to fund performance and related risks, there are various other risks that can be a significant challenge for the intermediaries these days. A few examples of different types of risk and its impact are detailed below:

Compliance Risk - Failure by the AMC to meet its regulatory obligations or manage changes in legal statutory and regulatory requirements may result in investigations, fines, financial forfeiture, or regulatory sanctions and material loss to investors and the organization. Compliance risk is not just the non-adherence of the relevant terms under which the license has been provided to the mutual funds, but also the various extant circulars and guidelines. This shall include circulars relating to specific risks like information security, business continuity, insider trading, to name a few. The asset management companies owe fiduciary responsibility to the investors, whose funds they manage. The best course of action at each given moment is to do what is right.

One should consider if they are acting morally in any conversation pertaining to a compliance issue, eespecially in terms of what is best for investors.
The idea of "doing the right thing" for investors needs to serve as the foundation on which every regulation and the management of mutual funds should hold close to every decision they take.

SEBI has been strongly emphasising strict regulatory regime, these days. The penalties to various mutual funds – fund houses, asset management companies and key officials are increasing. These are not just financial penalties but declaring them not 'fit-and-proper' to operate in the securities markets.

Information Security and Cyber Risk - With rapid technological advancement in securities market, there is greater need for maintaining robust cyber security and to have cyber resilience framework to protect integrity of data and guard against breaches of privacy. As part of the operational risk management, the Mutual Funds / Asset Management Companies (AMCs) need to have robust cyber security and cyber resilience framework in order to provide essential facilities and services and perform critical functions in securities market ***(SEBI Circular - Cyber Security and Cyber Resilience Framework for Mutual Funds / Asset Management Companies (AMCs), 2019).*** With the growing importance of information security due to the arrival of an information society and the spread of the

internet, information security is emerging as a tool to guarantee competitive advantage and is at the same time an indispensable requirement for stable business execution for companies and organizations. Additionally, the value of tangible and intangible assets that need to be protected as components of corporate assets are on the rise, where the importance of efficient and effective information asset management and information security investment is increasing for the organizations and companies managing them ***(Kong et al., 2012).*** SEBI has laid a lot of emphasis on information security and cyber risk that mutual funds are exposed to. There are specific circulars that mandate the intermediaries to take precautions about, failing which the consequences could impact the organisation a lot. SEBI has cast a lot of obligations on the mutual funds, including the Boards of Directors of the Asset Management Companies and the Trustees, to ensure the mutual fund operations are adequately protected. Separate circulars have been issued by SEBI in relation to information security and business continuity.

Outsourcing Risk - This paper examines the causes and consequences of mutual fund outsourcing to different types of service providers - advisors, custodians, administrators, and transfer agents. The data indicate outsourcing is less common among bank-managed funds, funds of leading groups, but more common among funds that are distributed through third parties ***(Cumming et al., 2015).*** In India, Custodianship of assets under management has to be mandatorily outsourced, by regulations. Fund Accounting and Transfer agency can be carried out, in-house. However, these are outsourced and concentrated with handful of players. This oligopolistic nature of service providers could cause the mutual funds to be held in ransom at the mercy of service providers.

Talent Risk – Managing mutual funds involves specialised skills. Higher skilled managers manage larger funds and reap higher rewards. One of the results is that investors appear to be able to identify talent and compensate for it, that is, current compensation predicts future performance. The most surprising result is that investors appear to be able to detect this skill and use this information to invest their capital. Managerial compensation, computed as the product of AUM and the percentage fee, is primarily a function of fund size, so investors, by allocating their capital to funds, determine managerial compensation ***(Berk & van Binsbergen, 2015)***. Given the short supply of talented fund managers and other key personnel, the mutual fund industry is plagued with talent risk. The performance of the fund could be impacted by the large amount of funds that he/she manages. It is also attributed that the longer the fund manager has been managing the fund, the better is the fund performance. The ace fund manager leaving the fund house could impact the fund performance. The

same is true with other key functions like risk management, compliance, sales and distribution departments.

A continuing effort to identify and evaluate the most probable and important sources of future risk for the business should be part of the risk management framework of the organisation. This analysis should cover how the structure and interrelationships of current risks may evolve, as well as how the company.

Company procedures are designed to foresee potential dangers. This involves being aware of the risks. risks posed by the competitive environment, the company's strategic ambitions, and the futuristic effects of technological advancements and other changes on the business's profitability and prospects of long-term, sustainable value development. Seeing potential hazards ahead of time is essential to prevent or reducing the hazards before they become emergencies. In prioritizing such matters, the board can send a message to management and employees that comprehensive risk management is not an impediment to the conduct of business nor a mere supplement to a firm's overall compliance program, but is, instead, an integral component of strategy, culture and business operations ***(Lipton et al., n.d.)***

Research Gap

Conducting research on the adequacy of regulations in enhancing risk management and governance in mutual funds in India is multi-faceted and driven by critical considerations within the financial landscape. There is a notable dearth of research specifically focusing on various other types of risks and practices that mitigate all those risks. Further, study on the Indian mutual fund industry's risk management and governance practices within the context of regulatory changes, is non-existent.

Understanding of the various types of risks: Most research in mutual fund industry, has been related to fund performance, liquidity and credit or investment risk related. There are many more non-financial risks that are not usually given appropriate priority. Financial instruments generally involve risk. Investment in shares involves business risk, investments in bonds involve interest rate risks, investments in currencies involve exchange rate risks, and investments in fixed deposits involve risk of default. As mutual funds invest its corpus in all these risky assets, investment in mutual funds is the sum of all the above risks***. (Dhankar, 2019)*.**

Regulatory Changes: The Indian securities markets have undergone significant regulatory changes and reforms in recent years. The comprehensive risk management framework of September, 2023 is a good example, in relation to mutual funds. **(*SEBI | Risk Management Framework (RMF) for Mutual Funds*, 2021)**. Much has been done to streamline the fund offerings, transparency amongst fund houses. The risk management framework is relatively new, and is very different from the earlier risk management circular that was enforced two decades earlier **(*SEBI Circular - Risk Management System* -, 2002)**. Understandably, there is limited evidence on how the new risk management framework has translated into effective risk management and governance practices within mutual funds. An understanding of this and how it compares with the 2002 circular could be useful in giving different perspectives.

Investor Protection: Ensuring robust risk management and governance practices is essential for protecting the interests of retail investors who constitute a substantial portion of the mutual fund investor base. The exponential growth of mutual funds investor base, especially in the aggressive equity schemes, is a point for consideration. An empirical investigation into the impact of regulations on these practices directly contributes to enhancing investor protection.

Fund Manager Performance: Much of the fund's performance is related to the performance of the fund manager. There is a lot of dependency on the fund manager's qualifications, age, experience in the industry and importantly, how long they have been managing the fund that is being considered. Statistical tests consider performance, risk and fees simultaneously to avoid biased results produced by earlier studies that ignore simultaneity. Results show that a fund's performance, risk and fees are significantly impacted by its manager's characteristics ***(Golec, 1996).*** No such study seems to have been done about the personal characteristics of fund managers, and their performance.

Governance: The mutual fund industry plays a crucial role in channeling funds into the capital markets. Therefore, understanding how regulations influence risk management and governance is pivotal to ensuring market stability and mitigating systemic risks.

The purpose of this research is to review and analyse existing studies and their findings, summarising the efforts of research in risk management and governance in the mutual funds industry. Reserve Bank of India (RBI) deputy governor M.K. Jain opines that the compliance culture of Indian banks is unsatisfactory. During the supervising process, RBI has observed lacunae in the compliance culture of Indian banks. Some of the weaknesses and irregularities observed have been recurring in spite of the commitments by RBI ***(Compliance Culture of Indian Banks Unsatisfactory, 2019).*** Banking regulations

have been around for a long time, and best practices guided by Bank for International Settlements (BIS), which is adopted by banks world over. If there is a lacuna in banking, it is worth evaluating how the mutual funds compliance culture is, in India.

This study addresses a significant gap in the academic literature by providing empirical evidence of the impact of regulatory measures on risk management and governance practices in the Indian mutual fund industry, contributing to the broader field of financial regulation and governance research.

Research Objectives

The primary objective of this doctoral research is to comprehensively evaluate the impact and effectiveness of regulatory frameworks on enhancing risk management and governance standards within the mutual fund sector in India. The study aims to provide insights into how these regulations have influenced the overall risk culture, investor protection, and operational transparency within the industry.

The broad objectives are:

- Analyze the various risks encountered by the Indian Mutual Fund Industry and assess the sufficiency of the existing framework in addressing them.
- Examine the various risks emanating from fund managers and evaluate if there are any factors that hinders their ability to perform well consistently.
- Analyze existing methods, processes, and practices to identify gaps in implementing regulations aimed at improving risk management and governance.
- Recommend strategies and practices to overcome the implementation challenges and enhance risk management in the industry.
- Compare risk management and corporate governance practices in the Indian market with more mature and developed markets like the US or UK.
- Present the study's findings to SEBI and AMFI for examination and potential incorporation of emerging ideas or themes into regulatory frameworks.

Research Questions

This study aims to review the various blockchain applications currently available, initiatives being pursued and how the same is being used to mitigate risk in the securities industry in India.

To meet this objective, we will have the research questions below focus more focused:

- Whether the regulatory framework prescribed has identified all risks that mutual fund industry and investors encounter?
- Whether the regulatory framework has addressed all identified risks?
- To what extent have regulatory interventions improved risk management practices within Indian mutual funds?
- How have governance structures evolved in response to regulatory changes in the mutual fund industry?
- Are there any gaps or challenges in the current regulatory framework that hinder effective risk management and governance practices?
- How do mutual fund managers perceive and adapt to regulatory requirements related to risk management and governance? Whether mutual fund in India visualise risks beyond what is articulated in the regulatory framework?
- Whether Indian mutual fund industry takes implementation of risk management framework prescribed as a compliance exercise or the industry has imbibed this into their management culture?
- Are the Board of Trustees and the Board of Directors of the AMC ready to face the new obligations and challenges cast upon them?
- How have regulatory changes in India impacted the risk management strategies adopted by mutual funds?
- What are the key challenges faced by mutual funds in complying with regulatory requirements related to risk management and governance practices?
- How do mutual funds adapt their governance structures in response to evolving regulatory requirements?
- Are there differences in the impact of regulatory measures on risk management and governance practices between large, established mutual fund companies and smaller, newer entrants?

- How do mutual funds balance the need for regulatory compliance with the pursuit of investment performance and returns for their investors?
- How do mutual funds in India compare with their global counterparts in terms of regulatory compliance and risk management practices?
- What is the investor perception of the regulatory framework in India concerning mutual funds, and how does this perception influence investment decisions?

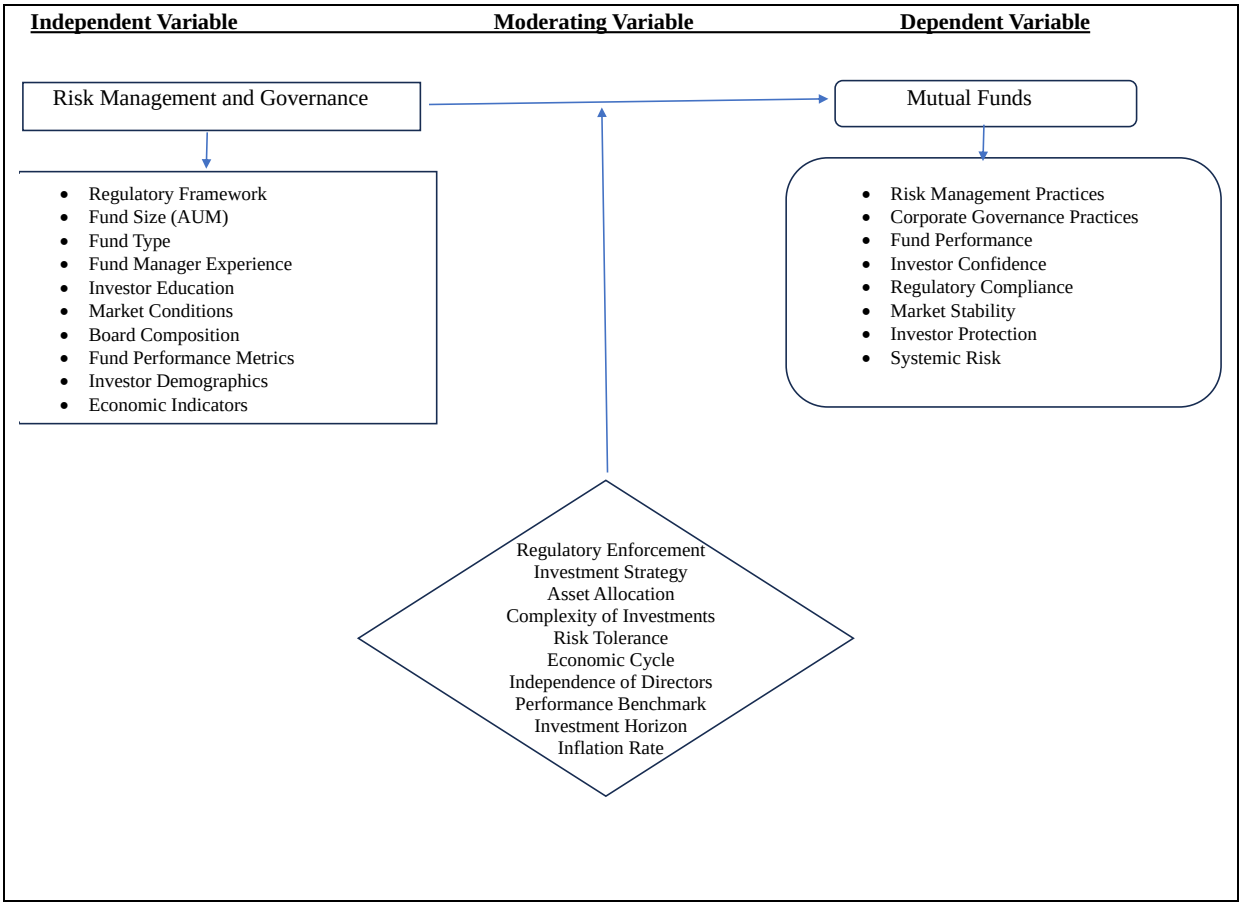
The above are an indicative list of questions that will be suitably modified, as we get deeper into the study, to meet the desired outcomes. These will be appropriately used in developing questionnaires customised to each stakeholder.

Formulation of Research Variables

For this research, a range of independent, dependent, and moderating variables have been identified. The independent variables include elements such as the regulatory framework, fund size, fund type, fund manager experience, fund performance metrics, investor demographics, etc. These factors represent the key drivers and contextual factors within the Indian mutual fund industry. The dependent variables encompass risk management practices, corporate governance practices, fund performance, investor confidence, regulatory compliance, and systemic risk. These reflect the core outcomes and performance metrics of interest.

Additionally, moderating variables like regulatory enforcement, investment strategy, asset allocation, complexity of investments, risk tolerance, performance benchmark, etc, have been introduced to account for the nuanced influences and interactions that may shape the relationships between our independent and dependent variables. This comprehensive set of variables forms the foundation for our research framework. It allows us to explore the multifaceted dynamics of risk management and governance within the Indian mutual fund industry and their impact on various performance and investor welfare dimensions.

The three variables have been represented in a schematic in the following page.



While these variables have been the basis of our formulating the research proposal, there could be some variation in these variables, as we explore and get into the details of the topic.

Hypothesis of the Study

Based on the understanding of the market, literature review and the propositions that emerged, few hypotheses have been propounded. These will need to be further refined and further subject to modifications in the course of the study. The hypothesis and the alternate hypothesis that are considered are as follows:

Hypothesis

Null Hypothesis (H0)	Alternate Hypothesis (H1)
A large volume of Average Assets Under Management of a Fund will have no effect on the quality of risk management and governance.	Large volume of Average Assets Under Management of a Fund has an effect on the quality of risk management and governance.

Null Hypothesis (H0)	Alternate Hypothesis (H1)
There is no effect of the quality of risk management on the performance of the fund.	Quality of risk management has an effect on the performance of the fund.
Proportion and profile of independent (outside) Directors has no effect on the quality of risk management and governance.	Proportion and profile of the independent (outside) Directors has an impact on the quality of risk management and governance.
ESOPs held, and remuneration of Fund Managers have no influence on the performance of the fund held by executive managers and remuneration and the quality of risk management and governance.	ESOPs held, and remuneration of Fund Managers influences the performance of the fund held by executive managers and remuneration and the quality of risk management and governance.
Quality of risk management and fund performance is not impacted by the tie-up with shareholding with foreign firms.	Quality of risk management and fund performance is impacted by the tie-up with shareholding with foreign firms.
Mutual funds in India are risk-free due to prescription of risk frame work and regulatory oversight and strict adherence to the same by the industry.	Mutual funds in India are not risk-free due to prescription of risk frame work and regulatory oversight and strict adherence to the same by the industry.
Compliance culture in Indian mutual funds is very strong and does not impact the quality of risk management and governance.	Compliance culture in Indian mutual funds is impacted the quality of risk management and governance.

Research Methodology

The research methodology for the study on the effectiveness of regulatory measures in enhancing risk within the Indian mutual fund industry, is a new area. A formal and demanding risk management framework is less than 2 years old, as of August 2023. Therefore, an exploratory study as to the concept, its exhaustiveness, effectiveness, and challenges in implementing the regulations will be relevant. Further, how does the risk management framework compare with regulations in other developed countries could be very relevant too.

There are certain risks that can be assessed using the existing data from primary and secondary sources. These relate to fund performance, fund manager skills, attracting a fresh inflow of subscriptions from the investors.

The research will entail using a combination of exploratory and quantitative approach.
This will involve a combination of primary and secondary research methods, primarily utilizing a qualitative research approach. Here is a summarized overview of the research methodology:

Data Sources

Primary Data: Semi-structured interviews will be conducted with key stakeholders, who may include mutual fund managers, CEOs, asset managers, regulatory authorities, industry experts, risk & compliance officers, and others who can provide insights into regulatory compliance, risk management, and governance practices. These interviews will provide in-depth, subjective insights into the impact of regulations on risk management and governance.

Secondary Data: Secondary information will be collected through a review of previously published works, reports, regulatory documents, and other reputable sources. This will supplement the primary data and provide historical context.

Analysis of Circulars: Circulars and regulations issued by the regulator will be analysed to assess their comprehensiveness and compare them with the practices obtained in other parts of the world and prescriptions of comparable regulators like regulators of Insurance industry, Banking industry and IOSCO.

Sampling Method

Quota Sampling: Participants for interviews will be selected using a quota sampling methodology. This approach ensures representation from various segments of the Indian securities industry, including regulators, exchanges, clearinghouses, depositaries, depositary participants, stockbrokers, transfer agents, investors, and technology vendors. To gain a different perspective, a firm with international tie-up, public-sector backed firms, and those with varying assets under management may be included in the survey.

Sample Size

The number of mutual funds in India is approximately 45. Of these about 40 of them may have a sufficiently long presence in the market. Accordingly, the number of stakeholders like the CEO, Fund Managers, Compliance Officers etc. will also be limited. Further, the number of service providers like custodians, fund accountants and transfer agents are also limited. For instance, there may be about eight (8) custodian & fund accountants, while there are only two (2) Transfer Agents. Keeping this in mind, the following sample size is proposed.

Market Participant / Stakeholder	**Sample Size**
Chief Executive Officer	5
Chief Risk Officer	10
Chief Compliance Officer	10
Fund Managers	10
Operations Managers	10
Regulators & SRO	3
Directors & Trustees	10
Distributors	20
Banks	5
Auditors	7
Custodian, Fund Accountant & TA	5
Market Experts and Media	5
	100
Investors	400
Total	**500**

The study shall endeavour to cover various stakeholders in the mutual funds ecosystem. For the purpose of sample, the sample would include even those who have recently remitted office, up to three (3) years, but with sufficient experience. Further, the investors will cover those residing in Mumbai.

The samples will be drawn from fund houses that have been in existence for at least 3 years.

Research Approach

The study combines elements of descriptive and exploratory research designs. This approach allows for an investigation of both the effectiveness of regulations and the identification of significant changes and problems in the industry.

Data Collection:

Data will be collected through semi-structured interviews with key industry participants. These interviews will delve into their experiences, perceptions, and challenges related to regulatory

measures. This approach helps to gather qualitative insights and in-depth information from key stakeholders.

The process will begin by identifying the key stakeholders relevant to the research objectives. This would include stakeholders who may include mutual fund managers, CEOs, asset managers, regulatory authorities, industry experts, risk & compliance officers, and others who can provide insights into regulatory compliance, risk management, and governance practices. From this list, employing quota sampling methodology participants will be carefully selected to ensure representation from all stakeholders.

A list of interview questions is developed that aligns with your research objectives. These questions are designed to elicit detailed information about regulatory compliance, risk management practices, governance structures, challenges faced, and any innovative strategies adopted. Semi-structured interviews provide a flexible framework where you have a set of predetermined questions but also allow for open-ended follow-up questions. A pilot test may be considered with few participants to check on the clarity and relevance. It is proposed to follow an open and free-flowing approach that encourages participants to elaborate on their experiences and perspectives.

Data Analysis:

It is proposed that a mixed methodology is adopted, combining both qualitative and quantitative approaches. This approach shall provide a comprehensive understanding of the research topic.

Qualitative Analysis:

- Content analysis techniques will be used to analyze qualitative data from interviews and textual sources, identifying recurring themes and patterns. Qualitative analysis is a crucial component of research methodology, especially for understanding the subjective aspects of the impact of regulatory measures on risk management and governance practices.

- Qualitative data in the study will be primarily gathered through semi-structured interviews with key stakeholders, including the Board of Directors, Board of Trustees, Fund Managers, CEOs, Compliance Officers and Chief Risk Officers amongst other industry experts. Depending upon the progress, stakeholders like internal & statutory auditors, service providers like Transfer Agents, Custodian and Fund Accountants will be covered. Regulator and Industry SRO, AMFI will also be considered.

- These interviews will be designed to elicit detailed information, opinions, and insights from participants regarding their experiences, perceptions, and challenges related to regulatory compliance, risk management, and governance practices.

Quantitative Analysis:

Quantitative analysis is a crucial component of the research methodology, especially for assessing the impact of regulatory measures on risk management and governance practices within the Indian mutual fund industry.

Quantitative data for the study will be sourced from various sources, both internal to the mutual funds and external. These would be company websites, annual reports, portfolio statements amongst others. External sources include AMFI, regulatory filings, mutual fund performance reports from service providers etc. These data sources would provide quantitative metrics and indicators related to regulatory compliance, risk management, and governance practices.

Appropriate tools like Statistical Package for Social Sciences (SPSS), will be used for quantitative data analysis, other than spreadsheets.

Ethical Considerations

Ethical guidelines and standards will be strictly followed in the research, especially concerning the handling of sensitive data and ensuring informed consent in interviews. Adhering to ethical guidelines and standards helps protect the rights and well-being of participants and ensures the credibility and integrity of the research. It is proposed to adhere to the following considerations:

- Before conducting interviews, provide participants with a clear and comprehensive explanation of the purpose of the study, the interview procedures, and what their participation will entail.

- Fair and unbiased selection of participants shall be ensured, without any discrimination.

- Emphasize that participation is entirely voluntary, and participants have the right to withdraw from the study at any time without consequences.
- Participants shall be assured that their identities and responses will be kept confidential.

- All collected data, both quantitative and qualitative, shall be protected, to prevent unauthorized access or disclosure. Secure storage methods for physical and digital data shall be used. If necessary, shall anonymize or pseudonymize participant information to further protect confidentiality.

- Any potential harm that participants might experience as a result of participating in the study should be considered, and measures taken to minimize it.

Reporting and Dissemination

Research findings will be presented clearly and comprehensively in a research report or thesis. The results will also be considered for publication in academic journals and shared with industry stakeholders and regulatory bodies. Research findings shall be clearly and comprehensively reported and actively seeking publication in academic journals. The report shall be shared with industry stakeholders and regulatory bodies, to maximize the impact of the research and contribute to informed decision-making in the mutual fund industry in India.

Implications

The research topics will focus on understanding the influence of regulatory guidelines on risk management practices within the Indian mutual fund industry. This research has the potential to uncover valuable insights into the interplay between regulations, risk management, and governance, offering critical implications for the industry and its stakeholders.

The implications drawn from this research will be multi-pronged. Firstly, it will underscore role of robust regulations in bolstering risk management and governance practices within mutual funds in India. Well-defined guidelines serve as a catalyst, encouraging fund managers to adopt prudent strategies while curbing unwarranted risks.

The research will study if effective regulations are instrumental in empowering the mutual fund sector in India to adeptly navigate uncertainties. By doing so, they play a crucial role in securing investor

protection and fostering systemic financial stability within the dynamic economic environment of India.

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